

**IN THE UNITED STATES BANKRUPTCY COURT**  
**FOR THE DISTRICT OF IDAHO**

**IN RE**

POND, CLARENCE and SUSAN,

**Debtors.**

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R & R HARDWOOD, VERNES  
QUALITY CONCRETE, CC  
CABINETS, NORTHWEST  
TAPING & HANGING,  
WESTERN HEATING & AIR  
CONDITIONING, EAGLE  
CONCRETE PUMPING,  
PETTITT COMPANY  
ELECTRICAL,  
INTERMOUNTAIN WEST  
INSULATION, VALLEY TRUSS  
COMPANY, INC., SCOTT  
MYERS WOODMASTERS,  
CARPETS PLUS, SNAKE  
RIVER ROOFING, EVANS  
BUILDING CENTER, a Division  
of BROWNS INDUSTRIES,  
INC., and URQUIAGA'S  
CONCRETE,

**Plaintiffs,**

**vs.**

**Case No. 99-00852**

**Adv. No. 99-6111**

**MEMORANDUM OF DECISION  
RE DEFENDANTS' MOTION  
TO DISMISS**

ACTION MORTGAGE CO./	)
STERLING SAVINGS BANK,	)
LEAH MARCHBANKS,	)
CLARENCE POND,	)
CHARLENE ULRICH and	)
SHANNON HOENSHELL,	)
	)
<b>Defendants.</b>	)
_____	)

Dennis M. Charney, GARDNER & CHARNEY, Boise, Idaho, for Plaintiffs.

Leslie R. Weatherhead and Dennis M. Davis, WITHERSPOON, KELLEY, DAVENPORT & TOOLE, Spokane, Washington and Willis E. Sullivan, CANTRILL, SKINNER, SULLIVAN & KING, Boise, Idaho, for Defendants Action Mortgage Co./Sterling Savings Bank.

Douglas J. Siddoway, RANDALL, DANSKIN, Spokane, Washington, for Defendant Charlene Ulrich.

J. Charles Hepworth, HEPWORTH, LEZAMIZ & HOHNHORST, Boise, Idaho, for Defendant Leah Marchbanks.

Robert A. Faucher, HOLLAND & HART, Boise, Idaho, for Defendant Hoenshell.

Brent T. Robinson, LING, NIELSEN & ROBINSON, Rupert, Idaho, for Defendant Clarence Pond.

### **Background.**

In this adversary proceeding, Plaintiffs, a group of home construction materials and service suppliers, seek a money judgment against Defendants, who include a home construction contractor, a mortgage lender and

its affiliate, and several of the lender's employees. Plaintiffs allege Defendants collectively violated the Racketeer Influenced and Corrupt Organizations ("RICO") statute in Title 18 of the United States Code and the Idaho Racketeering Act contained in Idaho Code § 18-7801 *et. seq.* Plaintiffs also seek declaratory relief that their liens have priority over the lender's liens on the houses built by the contractor with Plaintiffs' goods and services, together with a determination under Section 523 of the Bankruptcy Code that the contractor's debt to them is excepted from discharge in his bankruptcy case.

On July 7, 1999, all Defendants except the Debtor/contractor, Clarence Pond, jointly filed a motion to dismiss Counts One and Two of Plaintiffs' Complaint, comprising two of the RICO claims made against the Defendants. These Defendants assert that: (1) Plaintiffs lack standing to assert the racketeering claims; (2) the Complaint failed to state claims for which relief could be granted; (3) this Court lacked personal jurisdiction over Defendant Charlene Ulrich; and (4) this Court has no subject matter jurisdiction over these claims. A hearing was held on August 18, 1999, after which the matter was taken under advisement.

## **Applicable Law**

The purpose of a motion to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure, made applicable in bankruptcy proceedings by Fed. R. Bankr. P. 7012, is to test the legal sufficiency of a plaintiff's claims for relief. In determining whether a plaintiff has advanced potentially viable claims, the complaint must be construed in a light most favorable to the nonmoving party and its allegations of material fact taken as true. *Vignolo v. Miller*, 120 F.3d 1075, 1077 (9<sup>th</sup> Cir. 1997).

"Plaintiffs have the burden of establishing personal jurisdiction but need to make only a prima facie showing of jurisdictional facts to avoid a motion to dismiss." *Goodson v. Rowland (In re Pintlar Corp.)*, 133 F.3d 1141, 1144 (9<sup>th</sup> Cir. 1998).

Plaintiffs, as the party invoking federal court jurisdiction, bear the burden of establishing the existence of subject matter jurisdiction. *Trentacosta v. Frontier Pacific Aircraft Industries, Inc.*, 813 F.2d 1553, 1559 (9<sup>th</sup> Cir. 1987)(quoting 5 C. Wright & A. Miller, *Federal Practice and Procedure*, § 1363, at 653-54 (1969)).

## **Facts**

From the allegations of Plaintiffs' Complaint, the facts can be summarized as follows.

Defendant Action Mortgage Company ("Action") is a wholly owned subsidiary of Defendant Sterling Savings Bank. Action employed Defendants Leah Marchbanks ("Marchbanks") and Shannon Hoenshell ("Hoenshell") in its Boise, Idaho office, authorizing each to assist in the preparation of open construction loan draw requests and other details concerning administration and disbursement of construction loans. Charlene Ulrich ("Ulrich") is alleged to have been an employee of Defendant Sterling Savings working in its Spokane, Washington offices. Ulrich was also authorized to assist in the preparation of open construction loan draw requests and other details concerning construction loans.

Defendant Clarence Pond owns Pond Construction, Inc., a company which was engaged in the construction of new homes. Pond contracted with Plaintiffs to supply labor and materials for certain homes to be constructed by Pond Construction. Financing for the construction of the new homes at issue was obtained by the homeowners through Action via Sterling Savings. Funds were disbursed to Pond from the construction loans made to the

homeowners based upon written draw requests prepared by Defendants Marchbanks, Hoenshell, or Ulrich. The draw requests were prepared, and loan proceeds disbursed, without obtaining the contemporaneous signature approval of the homeowner/borrowers. Instead, a form was used that the borrowers had allegedly signed at some earlier time “in blank.” The details on these forms concerning the amount of the respective draw, and the various expenses to which the draw was to be applied, was allegedly filled in at a later time. The loan proceeds were sent to Pond, but Plaintiffs allege the money was not used to pay for the labor and materials listed on the draw requests. Instead, Plaintiffs allege, Pond used the funds for other purposes.

Defendant Clarence Pond and his company, Pond Construction, Inc.,<sup>1</sup> filed bankruptcy petitions.

## **Discussion.**

The federal RICO statute provides for the recovery of treble damages by “[a]ny person injured in his business or property by reason of a violation of section 1962 . . . .” 18 U.S.C. § 1964(c). Section 1962 prohibits

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<sup>1</sup> Pond Construction, Inc., is not named as a defendant in this action.

certain activities related to patterns of racketeering activity. 18 U.S.C. § 1962(a)-(d).

The Idaho Racketeering Act is very similar to RICO and Idaho courts have looked to federal cases to interpret the Idaho statute. *State v. Nunez*, 1999 WL 430490 (Idaho 1999). For this reason, the Court sees no reason to distinguish in its analysis of Count One, based on RICO, and Count Two, based on the Idaho Racketeering Act.

**A. Personal Jurisdiction Over Defendant Ulrich.**

Before addressing Defendants' contentions that Plaintiffs lack standing to pursue a RICO action against them, the Court must resolve Defendants' jurisdictional challenges. Defendant Ulrich asserts that this Idaho Bankruptcy Court cannot assert personal jurisdiction over her because she is a resident of the state of Washington. The Court disagrees.

The rule governing personal jurisdiction in an adversary proceeding, Fed. R. Bankr. P. 7004, provides in relevant part that:

If the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons or filing a waiver of service in accordance with this rule or the subdivisions of Rule 4 F. R. Civ. P. made applicable by these rules is effective to establish personal jurisdiction over the person of any Defendant with respect to a case under the Code or a

civil proceeding arising under the Code, or arising in or related to a case under the Code.

Fed. R. Bankr. P. 7004(f). Thus, personal jurisdiction over a nonresident defendant exists in an adversary proceeding so long as the person is served according to Rule 7004 or applicable portions of Rule 4 and the exercise of personal jurisdiction meets constitutional requirements. *Goodson v. Rowland (In re Pintlar Corporation)*, 133 F.3d 1141, 1144 (9<sup>th</sup> Cir. 1998). Here, Ulrich was served by regular first-class mail on June 7, 1999, in accordance with Rule 7004(b). The Court has therefore acquired personal jurisdiction over her unless the exercise of that jurisdiction would be inconsistent with the Constitution.

The personal jurisdiction requirement is based on the Due Process Clause, recognizing and protecting an individual liberty interest. *Insurance Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702 (1982). The test is whether the assertion of personal jurisdiction will offend “traditional notions of fair play and substantial justice.” *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945). To satisfy due process, an individual’s presence in the forum state is not required, but it is necessary for an individual to have “minimum contacts” with the forum. *Burnham v. Superior Court of California, County of Marin*, 495 U.S. 604, 618-19 (1990).



Count One and Two of Plaintiffs' Complaint, which must be taken as true, allege that Ulrich was one of several figures who executed a scheme to defraud the Plaintiffs. They allege that draw requests were faxed by Action employees from its Boise office to Ulrich in Sterling's Spokane office for processing. The funds were disbursed to Pond, an Idaho contractor, by Ulrich in furtherance of the parties' business transaction, which originated and was entered into by Action and its agents in Boise, and which concerned the construction of homes located in Idaho. Sterling made the construction loans to the borrowers referred to in Counts One and Two who were Idaho residents, and the security for the loans consisted of Idaho real estate. While Ulrich was never physically present within Idaho, her activities as an alleged conduit in the business transactions constitute ample, and not merely minimum, contacts sufficient to support a suit against her in this District without offending traditional notions of fair play and substantial justice. Therefore, Defendant Ulrich's challenge to the personal jurisdiction of this Court is without merit.

**B. Subject Matter Jurisdiction.**

Defendants also assert that this Court lacks subject matter jurisdiction over the issues raised by Counts One and Two of Plaintiffs' Complaint. A bankruptcy court's subject matter jurisdiction is founded upon the

provisions of 28 U.S.C. § 1334. This statute grants to the federal district courts “original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b). In turn, 28 U.S.C. § 157(a) allows the district court to refer to the bankruptcy judge in the district “any or all cases . . . and any or all proceedings under title 11 or arising in or related to a case under title 11 . . . .” The United States District Court for this District has made such a reference in Amended General Order No. 38. If Plaintiffs’ claims fit within the categories described in Section 1334(b), the District Court has subject matter jurisdiction over those claims, and this Bankruptcy Court may exercise that jurisdiction via the reference under Section 157(a).

The Section 1334(b) terms “related to,” “arising in,” and “arising under” in the context of a bankruptcy case are terms of art. *Bowen Corp.*, 150 B.R. at 782. The term “related to” refers to a proceeding in which the outcome “could conceivably have any effect on the [bankruptcy] estate . . . .” *Fietz v. Great Western Savings (In re Fietz)*, 852 F.2d 455, 457 (9th Cir. 1988). An action is considered as “arising in” a bankruptcy case if it is one not based upon Title 11, but that would have no existence outside the bankruptcy proceeding. *Maitland v. Mitchell (In re Harris Pine Mills)*, 44 F.3d 1431, 1435 (9th Cir. 1995),

*cert. denied* 515 U.S. 1131 (1995); *Insulation Distributors, Inc. v. Waters (In re Waters Asbestos and Supply Co.)*, 225 B.R. 196, 198 (Bankr. D. Idaho 1998).

Finally, a proceeding “arises under” Title 11 when the action is “created or determined by a statutory provision of title 11.” *Harris Pine Mills*, 44 F.3d at 1435 (*quoting In re Wood*, 825 F.2d 90, 96-97 (5th Cir. 1987)).

Here, Counts One and Two of Plaintiffs’ Complaint allege racketeering claims against the various Defendants under federal and Idaho law. Neither of these claims are based upon provisions of the Bankruptcy Code, Title 11, nor do these claims depend upon the pendency of the Defendant Clarence Pond’s bankruptcy case for their existence.

Plaintiffs’ Count One and Two claims, at least as against Defendant Clarence Pond, appear related to Pond’s bankruptcy case since the outcome of this action could conceivably impact Mr. Pond’s bankruptcy estate. If Plaintiffs succeed with their actions against Pond, a significant claim may be established against Pond’s bankruptcy estate, and this Court has subject matter jurisdiction to entertain the action.<sup>2</sup>

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<sup>2</sup> Defendant Pond did not join with the other Defendants’ in moving to dismiss Counts One and Two, nor has he argued that this Court lacks jurisdiction to hear Plaintiffs’ claims against him. If Plaintiffs’ Count One and Two claims against Pond are characterized as “claims’ litigation,” that is, a dispute over a creditor’s assertion that Pond is indebted to Plaintiffs, the action can be seen as one “arising under” Title 11, or “arising in” the bankruptcy case, and this Court’s subject matter jurisdiction is clear.

However, as to the other Defendants, Plaintiffs' Count One and Two claims are not related to Pond's bankruptcy case. Instead, the action is one between alleged creditors of Pond. As such, the outcome of that litigation would have no demonstrable effect on the bankruptcy case.

Based upon this analysis, the Court concludes it has no subject matter jurisdiction over Plaintiff's racketeering claims under Counts One and Two of the Complaint against Defendants Action Mortgage, Sterling Savings, Leah Marchbanks, Shannon Hoenshell, and Charlene Ulrich. Those Defendants' motion to dismiss Counts One and Two should be granted for this reason.

### **C. Standing.**

Even assuming the Court could exercise subject matter jurisdiction over Plaintiffs' Count One and Two claims against any of Defendants, the Court alternatively concludes that Plaintiffs lack the legal standing to pursue such claims under the case law interpreting RICO.

To establish standing for purposes of a RICO action, a claimant must demonstrate its status as a "person injured in his business or property by reason of a violation of" the RICO statute. 18 U.S.C. § 1964(c). A "person" for purposes of RICO standing is "any individual or entity capable of holding a legal

or beneficial interest in property.” 18 U.S.C. § 1961(3). Plaintiffs all qualify under this element of the standing requirement.

Next, Plaintiff must show they have suffered an injury to their business or property as a result of Defendants’ alleged wrongful conduct. The moving Defendants argue that the injuries described by Plaintiffs in the Complaint are, at most, indirect results of the alleged RICO violations by Defendants. The Ninth Circuit recently outlined a three-prong test for determining whether an injury is too remote to serve as the basis for a recovery under RICO. *Oregon Laborers-Employers Health & Welfare Trust Fund v Research USA Inc.*, — F.3d —, 1999 WL 493306, \*3 (9<sup>th</sup> Cir. 1999). This “remoteness” test considers: (1) whether more direct victims of the alleged RICO violations exist which could pursue the claims as private attorneys general; (2) whether it would be difficult to ascertain the plaintiff’s damages resulting from the alleged wrongful conduct; and (3) whether the court would be required to adopt complicated apportionment rules to avoid the double recovery of damages. *Id.* These elements of the standing test are each examined below.

### **1. Existence of More Direct Victims.**

Plaintiffs allege that Action and its employees engaged in a fraudulent, perhaps even criminal, scheme by preparing draw requests using presigned blank forms, to obtain the disbursement of funds from Sterling Savings. Plaintiffs allege that the draw requests were executed in order to allow Pond to obtain the funds necessary to pay subcontractors for their labor and materials, but that instead, the loan funds were appropriated to other uses by Pond and were not used for the intended purpose. In this respect, Plaintiffs, as the subcontractors that were intended to be the ultimate recipients of the monies, are arguably the victims of the alleged misconduct.

Clearly, though, Plaintiffs are not the most direct victims of the alleged RICO violations described in Counts One and Two. The borrowers on the loans involved in Counts One and Two, homeowners Carol Dayton and Todd and Sheila Keim, suffered the most immediate damage resulting from any alleged scheme. The borrowers agreed to pay Pond Construction to build their homes. The contractor agreed to pay for all the labor and material used in constructing the homes. The borrowers obtained financing through Action/Sterling Savings, and each draw request on their loans was intended to relieve the borrowers of a portion of their obligation to Pond Construction. However, because Pond allegedly diverted the loan proceeds to other uses

instead of paying subcontractors, the borrowers are most directly in line for injury.

The subcontractors can assert liens against the borrowers' homes for their unpaid bills. Moreover, the homeowners have granted Sterling Savings a mortgage on their homes to secure their construction loans. While Plaintiffs are arguably impacted by Defendants' allegedly wrongful actions, the borrowers are the immediate victims of any mischief. Under this prong of the Ninth Circuit test, Plaintiffs lack RICO standing.

## **2. Difficulty in Ascertaining Damages Attributable to Wrongful Conduct.**

It would not be difficult to ascertain Plaintiffs' damages resulting from the Defendants' alleged wrongful conduct. To maintain a RICO claim, Plaintiffs must establish financial loss or injury. *Berg v. First State Insurance Company*, 915 F.2d 460, 464 (9<sup>th</sup> Cir. 1990). As alleged in Counts One and Two, each of the various draw requests itemizes specific payments for labor or supplies furnished by one of the subcontractors. While these amounts may not be the total owed each of the Plaintiffs by the contractor, they do represent the amount allegedly diverted from Plaintiffs by Defendants. As a result, the Court can match the draw request itemizations with the appropriate Plaintiff. Plaintiffs' claims satisfy this aspect of the standing test.

### **3. Potential for Double Recovery.**

Under the final prong of the Ninth Circuit's standing test, there is a potential for double recovery for the alleged RICO violations under the fact pled in Counts One and Two of the Complaint. For example, in two other pending adversary proceedings, *Dayton v. Pond, et. al.*, No. 99-6134 and *Crookham v. Pond, et. al.*, No. 99-6139, homeowners allege RICO violations were committed by the same group of defendants named here. The Court has already determined that the homeowners are more direct victims than Plaintiffs. The fact that at least one of these direct victims, Ms. Dayton, is pursuing Defendants for alleged RICO violations presents a strong possibility for potential double recovery. This factor favors the dismissal of Plaintiffs' claims.

In sum, after application of the remoteness test to this case, the Court finds that Plaintiffs' alleged injuries to their business or property are too remote for recovery under RICO. As a result, Plaintiffs have no legal standing to pursue the claims against the nondebtor Defendants stated in Count One and Count Two of their Complaint.

### **D. Rule 12(b)(6).**



Defendants also assert that the allegations of Plaintiffs' Complaint fail to state claims for which relief may be granted, warranting dismissal under Fed. R. Civ. P. 12(b)(6), as incorporated by Rule 7012. Because the Court has concluded it lacks subject matter jurisdiction over Plaintiffs' Count One and Two claims against the nondebtor Defendants, and because the Court concludes Plaintiffs lack legal standing to pursue those claims, the Court declines Defendants' invitation to examine the legal sufficiency of Plaintiffs' alleged claims.

### **Conclusion.**

For the reasons set forth above, and for other good cause, the Court concludes that Plaintiffs' claims alleged in Counts One and Two of the Complaint, except as against Defendant Clarence Pond, should be dismissed. This Bankruptcy Court lacks subject matter jurisdiction to adjudicate those claims against the nondebtor Defendants. Even if that jurisdiction existed, though, any damages or injuries suffered by Plaintiffs as a result of the alleged misconduct of the Defendants are too remote to recover under the case law interpreting RICO. Having reached such a conclusion, the Court declines to consider whether

Plaintiffs have stated a claim for which relief may be granted against those Defendants in Counts One and Two.

A separate order will be entered granting the non-debtor Defendants' Motion to Dismiss Counts One and Two.

DATED This 22nd day of September, 1999.

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JIM D. PAPPAS  
CHIEF U.S. BANKRUPTCY JUDGE

### CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

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CAMERON S. BURKE, CLERK  
U.S. BANKRUPTCY COURT

DATED: September 22, 1999

By \_\_\_\_\_  
Deputy Clerk